



Committee On Finance

Max Baucus, Chairman

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FINANCE COMMITTEE EXECUTIVE SUMMARY OF THE PENSION REFORM BILL

Pension Provisions

The Chairman's mark contains a number of provisions designed to protect workers' retirement savings.

Diversification of Defined Contribution Plan Assets. A typical defined contribution pension plan may keep workers locked into company stock contributed by the employer indefinitely. Employee Stock Ownership Plans (ESOPs), which by definition are highly concentrated in employer stock, are the only plans currently subject to diversification requirements, and they are only required to allow workers to begin diversifying their holdings once they reach age 55 and have 10 years of participation in the plan. The bill generally provides that publicly held companies must allow workers to divest themselves of company stock once they have completed 3 years of service (with a 3 year phase-in for stock contributed in previous years). Only free-standing ESOPs are exempt from the requirement.

Protection of Workers during Blackouts. Blackouts (also known as lockdowns) occur in every pension plan, usually during a change in plan administrators or investment options. Current law does not require employees be notified of an upcoming blackout, nor does it specifically clarify the employer's liability during blackouts. The bill generally requires 30 days advance notice for any period of over 3 consecutive business days in which workers will have their rights significantly restricted. The provision applies not just to the ability to direct investments, but also to the ability to take out plan loans or receive distributions. The bill also clarifies that a fiduciary will be liable for plan losses unless notice has been given, the blackout was reasonable under the circumstances and no other fiduciary duties were violated.

Providing Information to Assist Participants. Under current law, plan administrators are generally not required to provide benefit statements to workers except when the workers themselves request a statement, and then no more than once each year. There is also no requirement for pension investment guidelines and information to be provided. The bill requires quarterly benefit statements for defined contribution plans that allow workers to direct their own investments; annual statements for plans that do not allow worker investment direction; and once every 3 years to workers in defined benefit plans. The bill also requires all workers to receive annual investment guidelines and information that would, at a minimum, include: information on the benefits of diversification of investments; the differences in risk and returns of various forms of investments; and information on investment allocations based on age and years to retirement.

Fiduciary Duty to Provide Material Information. The bill requires sponsors of defined contribution plans to make sure that all material information the employer is required to disclose to investors under the securities laws also be provided to workers concerning investments in company stock in the worker's account. There is no comparable requirement in current law.

Electronic Disclosure of Insider Trading. The bill requires that companies sponsoring plans that allow workers to invest in employer stock disclose to plan participants any sale of stock by an officer, director, or affiliate of the employer that is required to be disclosed to the SEC. The information must be posted on the plan's website in a reasonably practicable timeframe after disclosure to the SEC.

Independent Investment Advice. Questions exist under current law concerning the extent of an employer's liability for investment advice given to participants, and these questions have had a chilling effect on the willingness of many companies to make investment advice available through their pension plan to their workers. The bill establishes a checklist that, once successfully completed by the employer, relieves him/her of liability for any losses that result from the investment advice given. The items that must be verified by the employer include: that the investment advisor is qualified; that the advisor accepts full fiduciary liability for any advice given; that the advisor is independent (does not have financial conflicts with respect to the plan); that the advisor will take into account employer stock held by the worker when providing its advice; and that the advisor has the necessary insurance coverage for any claim by a participant or beneficiary.

Clarification of Access to Remedies. Recent court decisions have raised uncertainty about the extent to which plan participants may sue a fiduciary on their own behalf to recover losses to their pension plan accounts. The bill clarifies the individual's right to sue.

Bonding of Fiduciaries. Under current law, fiduciaries are required to post a bond equal to 10% of the funds they handle, but not to exceed \$500,000. Fiduciary bonds are designed to cover losses stemming from fraud or dishonesty by plan officials, and the maximum bonding cap has not been raised since the mid-1970s. The bill increases the bond cap to \$1 million for plans containing employer stock.

Optional Forms of Benefit Calculations. Under defined benefit plans, participants generally may choose among a variety of forms of benefits. Treasury is working on regulations specifying the types of information that must be made available to workers before they must make these decisions, but the regulations did not get completed in last year's business plan and it is uncertain when they'll be issued. In the meantime, plan participants are faced with making decisions about benefit options, sometimes without fully understanding the financial consequences of these decisions. This can be particularly true in cases where one or more of the options effectively eliminates a type of benefit, such as an early retirement incentive, and that fact is not made clear to the participant. The bill requires the Secretary of Treasury to complete its regulations within 30 days of the bill's enactment, and expresses the Committee's expectation that the regulations will ensure that participants are making informed decisions as to which form of benefit to elect, including early retirement benefits are incorporated into the calculations.

Executive Compensation Provisions

The chairman's mark also contains four proposals to ensure appropriate taxation of executive compensation, including certain bonuses, loans, and deferred compensation arrangements.

Enforce Deferred Compensation Rules. Since 1978, the Treasury Department has been limited in its ability to enforce laws that determine whether executive deferred compensation arrangements should be taxed currently or deferred until the funds are distributed. The legislation would remove a 1978

moratorium on new regulations and permit Treasury to better define deferred compensation arrangements that merit deferral of taxation and those that should be taxed currently.

Prohibit Deferral On Compensation Parked in Offshore Trusts. In order for a trust to qualify as nontaxable deferred compensation, the monies in the trust must be subject to the claims of general creditors. Placement of funds in offshore trusts can be used to thwart attempts by U.S. bankruptcy courts to access these compensation arrangements. The legislation generally provides that funds in an offshore trust will be deemed not to be subject to the claims of creditors, and generally the funds will be taxed. An exception would be provided for situations where the employee for whom the trust is established provides personal services in the foreign jurisdiction.

Increase Withholdings on Bonuses. Under current law, employers may elect to withhold income tax on supplemental wages at a flat 27% rate. Most executives and employees receiving million dollar bonuses will ultimately be taxed at the rate of 38.6%. The proposal increases the withholding rate to the highest marginal tax rate (currently 38.6%) on supplemental pay of over \$1 million.

Clarify Definition and Tax Treatment of Executive Loans. Whether a payment to an executive is a loan or compensation is a facts-and-circumstances test. The legislation would clarify that a payment would be considered as compensation rather than a loan unless the arrangement met minimum standards (written debt instrument, established repayment periods, and adequate security). In addition, loans above \$1 million would be required to have an interest rate equal to 3 percentage points higher than the applicable government published rate.

MODIFICATION TO THE PENSION/EXECUTIVE COMPENSATION BILL

The chairman's modification incorporates eight amendments filed by members of the Finance Committee. Below is a brief explanation of each provision included in the modification, which Chairman Baucus intends to incorporate today.

Faster Right To Divest For Those Age 55 (Kerry-Snowe). The bill gives individuals the right to divest company stock contributed to a defined contribution account by the employer after three years of service. A transition rule permits companies to require the diversification of previously contributed stock over a three-year period. The amendment incorporated would permit immediate divestiture for employees who are nearing retirement (age 55 or older).

Teachers Benefit Plans (Baucus-Grassley). This amendment addresses two issues: retirement plans for teachers that provide retention bonuses, and plans that provide early retirement incentives. Retention bonuses are caught in a catch-22 which requires them to be valued for tax purposes when earned, even though it is impossible to calculate their value at that time because the retirement date is unknown. In the case of early retirement bonuses, most school districts pay teachers in different amounts based on age. Age is used because it is the basis for receiving different amounts from the state retirement system or social security. One appeals court has determined such a system violates the ADEA even though the program is voluntary. This amendment corrects both of these problems.

Exclude Broad-Based Stock Options From Wages (Hatch-Bingaman). The amendment provides for no taxation of the exercise of an incentive stock option (ISO) or under an employee stock purchase plan (ESPP), consistent with a recent Treasury announcement of an indefinite moratorium on requiring withholding of FICA and FUTA on ISOs and ESPPs.

Modify Holding Period Requirements For Stock Options For Executive Branch Appointees (Thompson). The amendment eliminates the holding period requirement for capital gains treatment with

respect to ISOs and ESPPs for executive branch appointees and nominees who are required to divest these holdings. Current law requires them to hold the options for either two years after the granting of the option or one year from the exercise of the option to receive this treatment. The Office of Government Ethics has urged this change.

2001 Interest Rate Adjustment For Defined Benefit Plans (Conrad). The economic stimulus bill provided a short-term alternative to the traditional interest rate used for computation of defined benefit contributions after Treasury suspended issuance of certain 30-year debt instruments. The modification affected contributions related to 2002 and 2003. The amendment would provide a more limited alternative computation for contributions related to 2001 (which are generally being made in 2002).

Automatic Rollovers of Certain mandatory Distributions (Bingaman). The amendment modifies a provision included in the pension section of EGTRRA to specify that amounts transferred from a qualified retirement plan to an IRA in an automatic rollover are no longer plan assets for ERISA purposes.

Chief Executive Officer Must Sign Federal Income Tax Return (Baucus). The amendment requires that the chief executive officer of a corporation must sign the federal income tax returns under penalties of perjury. Current law permits a signature by the president, vice-president, treasurer, assistant treasurer, chief accounting officer, or other officer duly authorized.

Other Pension Provisions (Grassley). The modification includes several provisions included in the Senate version of the pension section of EGTRRA, but not included in the final legislation due to concerns about the application of the Byrd Rule to those provisions.